No. 18,904

United States Court of Appeals

For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al.,

Appellants,

vs.

CITY OF NORTH SACRAMENTO, et al.,

Appellees.

On Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF OF APPELLEES

RAYMOND MCCLURE,
City Attorney of the City of North Sacramento,
500 Calvados Avenue,
North Sacramento, California 95815,

MARTIN MCDONOUGH,

DANIEL F. GALLERY,
520 Capitol Mall,
Sacramento, California 95814,

Attorneys for Appellees.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

Table of Authorities Cited

Cases

Statutes

Treatises

No. 18,904

United States Court of Appeals
For the Ninth Circuit

MARINE MIDLAND TRUST COMPANY, etc., et al.,
Appellants,

vs.

CITY OF NORTH SACRAMENTO, et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Northern Division

BRIEF OF APPELLEES

This Brief of the City of North Sacramento, its Mayor, Treasurer and Clerk, is in reply to the Brief of Appellants Marine Midland Trust Company and John R. McGinley, who are appealing from the Judgment of the United States District Court for the Northern District of California, Northern Division, (Halbert, J.), dismissing their complaint.

JURISDICTION

The District Court had no jurisdiction of the action. The action was brought in the District Court on the ground that plaintiffs were citizens of New York and

Connecticut respectively, and that defendant City of North Sacramento and its co-defendant officers were citizens of California. But as will be demonstrated in this Brief, plaintiffs omitted to join an indispensable party, to wit., Citizens Utilities Company of California, a California corporation, which would be on the side of the plaintiffs if present, hence there was no diversity and no jurisdiction in the District Court.

STATEMENT OF THE CASE

In their "Brief of Appellants", plaintiffs excerpt certain portions of the complaint as a statement of the case, but these excerpts present such a fragmentary picture of the background to this litigation that it is necessary to make a more coherent outline of the chain of events leading up to the complaint, to permit a proper understanding of the issues and contentions on this appeal.

The transactions out of which this case arose began in 1956 when the inhabitants of the City of North Sacramento[1] (hereinafter called the "City") authorized, at an election, the acquisition of the privately owned water system supplying the inhabitants of the City and adjacent areas (Tr. 5).

The system was owned by Citizens Utilities Company of California (hereinafter referred to as "Cit-

[1]The City of North Sacramento contains approximately 5.5 square miles and its 1960 population was 12,922 persons. It is located in Sacramento County, California, just across the American River from Sacramento, the State Capitol.

izens of California''), a corporation, incorporated, headquartered and doing business in California (Tr. 3). Negotiations for the purchase of the system were unsuccessful, and the City instituted proceedings in 1956 against the owner to acquire the system by condemnation (Tr. 6). The proceedings determining just compensation and whether the City had a right to condemn the water system lasted for nearly three years, and in 1959, the Sacramento County Superior Court rendered its Interlocutory Judgment of Condemnation in favor of the City, determining that the City had the right and power to condemn the system and that title thereto would vest in the City upon its payment of just compensation, found to be $2,206,000 as of December, 1956 (Tr. 6).

Citizens of California appealed the Interlocutory Judgment on several grounds, but without success. The California District Court of Appeal affirmed the Judgment in May, 1961,[2] and the California Supreme Court denied review on July 19, 1961 (Tr. 7).

The City then undertook to sell its previously authorized revenue bonds so that it might pay the just compensation required within the twelve month period allowed by C.C.P. 1251 (Tr. 8). In March, 1962, Citizens of California sought a stay of execution of the Interlocutory Judgment of Condemnation on the ground that the proceeds from the City's authorized revenue bond issue of $2,500,000 would not be sufficient to pay both the just compensation award and

---

[2]*City of North Sacramento v. Citizens Utilities Co.* (1961), 192 Cal. App. 2d 482 (Tr. 7).

claimed increases to the value of the system since 1956 (Tr. 8 and 9).[3] The California Superior Court refused to grant such a stay (Tr. 9), and another series of appeals was taken by Citizens of California. The California District Court of Appeal refused to issue a writ of review and/or prohibition on April 18, 1962 (Tr. 9), the California Supreme Court denied a hearing on May 16, 1962 (Tr. 11), and the United States Supreme Court dismissed Citizens' appeal from these rulings on November 5, 1962, *Citizens Utilities Co. v. Superior Ct.*, 371 U.S. 67, 9 L.ed. 2d 119.

The City did sell its revenue bonds in May, 1962 (Tr. 13), and deposited the sum of $2,206,000 with the Clerk of the Superior Court, whereupon that Court made and entered its Final Order of Condemnation on May 17, 1962, declaring the City to be the owner of the system (Tr. 18). Citizens of California then took a third series of appeals, this time challenging the Final Order of Condemnation, but these too were unsuccessful (*City of North Sacramento v. Citizens Utilities Co.* (1963), 218 A.C.A. 193, petition for hearing denied by the California Supreme Court on September 4, 1963). All possibility of further appeal on the Final Order was lost in late 1963 and the condemnation action is no longer pending in the State Courts.

---

[3]The owner of the utility is entitled to compensation for additions and betterments to the system made during the pendency of the condemnation proceeding; they are determined in a supplemental proceeding before the Public Utilities Commission (Pub. Utilities Code Sections 1416-1419).

Plaintiffs, who were not parties to the long and bitter litigation in the State Courts, filed this action in the United States District Court against the City, its Mayor, Treasurer, and Clerk, in August, 1962, to set aside the condemnation judgment, contending that the defendants had made certain fraudulent misrepresentations in effecting the sale of the City's Water Revenue Bonds, and that the proceeds thereof were therefore recoverable by the bondholders and could not be used or deposited into Court as an effectual payment of the just compensation award. Notwithstanding the fact that neither Citizens of California nor any of the City's bondholders were made a party to the action, plaintiffs sought an adjudication that the bonds were improperly and illegally sold, and prayed for judgment: (1) that the deposit of the $2,206,000 was not an effective payment to support the transfer of title and possession of the water system to the City (Tr. 23), (2) that the City holds the water system as trustee ex maleficio (Tr. 24), and (3) that the conveyance of the water system is null and void, and that it be returned to Citizens of California (Tr. 24).

Plaintiffs' claimed standing to challenge the bond sale and payment of the award is as assignees of the sole stockholder of Citizens of California, which is Citizens Utilities Company, a Delaware corporation (herein called "Citizens of Delaware") (Par. 9 and 10 of Complaint, Tr. 2). Citizens of Delaware had executed an Indenture of Mortgage and Deed of Trust in favor of the plaintiffs, pledging with plaintiffs all

its stock in Citizens of California to secure bonds issued by Citizens of Delaware (Par. 13 of Complaint, Tr. 3 and 4). In reinforcement of the pledge of stock, the Indenture further provided that plaintiffs would have the right to receive the proceeds from the condemnation of any property owned by Citizens of California.[4]

Plaintiffs state at the opening of their Brief that the allegations of the Complaint must be accepted as fact, particularly here because the District Court had denied defendant City's motion for summary judgment before granting its motion to dismiss the Complaint (Brief, p. 2). From the same denial, the plaintiffs also draw the conclusion that the District Court held that the facts, if established, would entitle the plaintiffs to relief (Brief, pp. 8 and 9).

Neither of these assertions will stand. This Court is not required to accept as true allegations which are erroneous interpretations of the law. Plaintiffs charge that defendant City made certain misrepresentations to the purchaser of its revenue bonds in failing to disclose "that California law required a con-

---

[4]Paragraph 13 of the Complaint alleged that plaintiffs, in addition to being pledgees of the stock, had a direct security interest in the water system itself, and intimated that Citizens of California had assigned to plaintiffs their rights to the award. They clarified this in the District Court however, disclaiming any direct security interest in the water system and stating that their right to receive the condemnation award was based upon their agreement, not with Citizens of California, but with its sole shareholder (pp. 53 and 54, Plaintiffs' Memorandum in Opposition to Motion for Summary Judgment). It is clear that plaintiffs have no interest in the property of Citizens of California, and no agreement exists between them.

demnor to pay interest on the amount of the condemnation award from the date of Interlocutory Judgment until the taking of possession, which in this case aggregated over $350,000" (Brief, p. 4). It was expressly held that the City was *not required* to pay such interest in the condemnation proceeding to which plaintiffs refer by the California District Court of Appeal some six months before plaintiffs wrote their Brief (*City of North Sacramento v. Citizens Utilities,* 218 A.C.A. 193).

Plaintiffs further charge misrepresentation in the City's nondisclosure of pending annexation proceedings "which posed a threat to the financial integrity of the bonds" (Brief, page 4), whereas it is legally impossible that annexation of territory outside defendant City to another City, which is forever a possibility, would affect the bonds.

Another charge of misrepresentation was that City delivered a "false" no-litigation certificate to the bond purchaser (Brief, page 5). This so-called fraud boils down to a charge that the City certified that no litigation was pending which would affect the validity of its bonds, at a time when Citizens of California still had the right to appeal to the United States Supreme Court on its contention that the City could not take possession of the water system without posting security for any supplemental award that might be payable (Tr. 12 and 13). Of course the possibility of appeal in that case did not and could not affect the validity of the City's bonds, and the United States Supreme Court dismissed the attempted appeal on this

question "for want of a substantial federal question." *Citizens Utilities Co. v. Superior Court* (1962), 371 U.S. 67, 9 L.ed. 119.

The District Court, in denying City's motion for summary judgment, only noted that material issues of fact existed (Tr. 39 and 40) without specifying any particular issues, and that ruling cannot be used to fortify the many baseless charges upon which plaintiffs rest their complaint.[5]

ARGUMENT OF THE CASE

1. THE DISTRICT COURT PROPERLY RULED THAT THIS ACTION CONSTITUTED A COLLATERAL ATTACK ON THE STATE COURT CONDEMNATION JUDGMENT.

The District Court properly dismissed the action as it constituted a collateral attack on the condemnation judgment rendered by the California Superior Court, and such an attack is not maintainable except upon the ground of want of jurisdiction, extrinsic fraud or collusion, and none of these were alleged in plaintiffs' action.

As the District Court recognized in its Opinion (Tr. 52 and 53), the Final Order of Condemnation of the California Superior Court found and determined

> "that plaintiff (City) has already paid into court for defendant (Citizens of California) the sum

[5]Under Rule 56(c) of the Federal Rules of Civil Procedure, the presence of material issues of fact precludes a summary judgment; its denial is not equivalent to a ruling that the complaint states a cause of action.

> of Two Million Two Hundred Six Thousand Dollars ($2,206,000) as the just compensation fixed in the Interlocutory Judgement,"

and that based upon said payment,

> "It Is Ordered, Adjudged and Decreed:
>
> I
>
> "That said condemnation and taking provided for in said Interlocutory Judgment of Condemnation in said proceeding is complete and final; plaintiff (City) fully has and owns the lands, properties and rights sought in said proceeding . . ." (Exhibit D to Answer).

The complaint in this action sought specifically an adjudication that

> "the deposit in the sum of $2,206,000 . . . is disqualified to serve as an effective payment and as a predicate for a transfer of title and possession of the said water system to defendant City"
>
> (and)
>
> "that the purported conveyance of the water system of Citizens of California was null and void, and that there be a return of the water system of Citizens of California by defendants . . ." (Tr. 23 and 24).

Thus this action was, as the District Court held, a clear and unquestioned attempt to overturn the determinations and judgment made by the State Court, but no grounds for sustaining such a collateral attack were shown.

> "The general rule applicable to a judgment rendered by a court having jurisdiction of the par-

> ties and subject matter is that unless reversed or annulled it is not open to contradiction or impeachment with respect to its validity or binding effect by parties or privies in any collateral proceedings. . . . A void judgment, however, may be collaterally attacked either by the parties or by strangers. . . . With respect to parties or privies such an attack is ordinarily limited to cases where the judgment is void on its face. . . . A stranger, however, whose rights would be prejudiced by its enforcement is not bounded by this limitation, but may attack a judgment for fraud or collusion. . . . But neither the parties, their privies nor strangers can attack a judgment of a domestic court of record . . . on account of mere errors or irregularities." *Assoc. Oil v. Mullin* (1930), 110 Cal. App. 385, 389.

Thus, even if the plaintiffs were strangers to the condemnation judgment they could not attack it for mere error or irregularity. They are however in privity with the condemnee in the State Court proceedings,[6] hence bound by the judgment unless they could show that it was void on its face, which they did not attempt to do.

The central theme of plaintiffs' appeal from the dismissal of their action (Point II of their Opening Brief) is that the collateral attack rule was improperly applied in that the questions raised by their complaint were not in fact raised or considered by

---

[6]They obtained their rights from and stand in the shoes of the stockholder of the corporation, who of course is bound by judgments against the corporation (*Gagnon Co., Inc. v. Nevada Desert Inn* (1955), 45 Cal. 2d 448, at 453; *Bank of America v. McLaughlin* (1937), 22 Cal. App. 2d 411 at 414).

the California Superior Court in making its Final Order of Condemnation.

But the bar to plaintiffs' action is not so narrow. The State Court judgment is final not only as to all questions which were actually raised by the parties, but as to all questions and contentions which could have been raised.

> " 'The judgment or decree of a court of competent jurisdiction upon the merits concludes the parties and their privies to the litigation, and constitutes a bar to a new action or suit involving the same cause of action, either before the same or any other tribunal;'
>
> "The principle goes even farther. 'The rule is often stated in general terms that a judgment is conclusive not only upon the questions actually decided and determined, but upon all matters which might have been litigated and decided in that suit.' " *Bank of America, etc. v. McLaughlin* (1937), 22 Cal. App. 2d 411, at 414 and 415.
>
> "It is the rule, long recognized in this country, that a judgment between the same parties is conclusive, not only as to the subject-matter in controversy in the action upon which it is based, but also in all other actions involving the same question, and upon all matters involved in the issues which might have been litigated and decided in the case, the presumption being that all such issues were met and decided." *Bingham v. Kearney* (1902), 136 Cal. 175, 177.
>
> "An adjudication is final and conclusive not only as to the matter actually determined, but as to every other matter which the parties might have litigated and have had decided as incident to, or

> essentially connected with, the subject-matter of the litigation, and every matter coming within the legitimate purview of the original action, both in respect to matters of claim and of defense. (citing cases)'' *Estate of Bell* (1908), 153 Cal. 331, 340.

Citizens of California did not raise the contentions respecting the validity of payment that plaintiffs have raised in the federal action, but it could have; it did move to stay the Final Order on other grounds, and it did appeal the Final Order on other grounds, unsuccessfully (*City of North Sacramento v. Citizens Utilities Co.* (1963), 218 A.C.A. 193, hearing by Supreme Court denied). No contention was made that the $2,206,000 was ''tainted'', or otherwise an ineffective payment, but Citizens of California could have come before the California Court by motion or otherwise and obtained a determination on those contentions (C.C.P. § 937, 1252); however, it did not do so. The plaintiffs, who obtained their rights from the sole stockholder of Citizens and who are therefor in privity with Citizens of California, cannot do so either, now that the Final Order of Condemnation has become final.

> ''a judgment on the merits against the corporation on the wrong alleged to have been done to it would ordinarily be res judicata in an action by the shareholders on behalf of the corporation for the same wrong.'' *Gagnon Co., Inc. v. Nevada Desert Inn, Inc.* (1955), 45 C. 2d 448, 453.

The decisions cited by plaintiffs on pages 24-32 of their brief differ from the instant case in many im-

portant respects. *Banco Nacional de Cuba v. Sabbatino* (S.D.N.Y. 1961), 193 F. Supp. 375, aff'd 307 F. 2d 845, cited by plaintiffs, involves federal v. state jurisdiction when the two Courts have the same action or controversy before them simultaneously and before either have proceeded to final judgment. If neither Court has yet rendered a judgment, there is of course no bar of collateral estoppel or res judicata to be raised. The only question is whether one action may proceed when the other Court has custody or control of the res or subject matter of the litigation.

> "But the mere adjudication by a federal court of a particular issue identical with an issue involved in *pending* litigation in a state court has never been considered so irritable to state prerogatives as to constitute a ground for federal abstention . . ." (emphasis added), *Banco v. Sabbatino,* 307 F. 2d at 854.

Moreover, unlike the case here, there was no privity or other relationship between the party claiming the property in the State Court action and the party claiming the property in the Federal Court action. *Banco* is hardly applicable to a case where the State Court has already rendered a judgment, binding against those with whom the federal action claimaint is in privity.

Markham v. Allen (1946), 326 U.S. 490, 90 L.ed. 256, was similar, in that there was no existing State Court judgment to which the Federal Court plaintiff (or his predecessors) had been a party. A probate proceeding was pending in the State Court, and Mark-

ham, a stranger thereto and claiming the property against the State Court claimants, brought them into the Federal Court and obtained a determination inter se as to his rights in the property. The federal judgment would conflict in no way with what the State Court was doing or had done.

> "The effect of the judgment was to leave undisturbed the orderly administration of decedent's estate in the state probate court . . ." (326 U.S. at 495)

In *Commonwealth Trust Co. v. Bradford* (1935), 297 U.S. 613, 80 L.ed. 920, there was no prior determination of rights binding the plaintiff in the federal action and it sought a determination of its rights in funds under the control of a pending State Court receivership proceeding. There was no final judgment out of the State Court and no question of res judicata or collateral estoppel raised. Likewise in *Waterman v. Canal Louisiana Bank Co.* (1909), 215 U.S. 33, 54 L.ed. 80, and *Byers v. McAuley* (1893), 149 U.S. 608, 37 L.ed. 867, the Supreme Court recognized the propriety of bringing an executor or administrator appointed in a *pending* State Court probate proceeding into the Federal Court for a determination of rights in the property of the estate in advance of the State Court making a determination thereof.

United States v. Klein (1930), 303 U.S. 276, 82 L.ed. 840, involved a state judgment respecting the ownership of unclaimed funds in the Federal Court, and the latter had made no determination respecting such ownership but was merely holding the funds for

whosoever might establish right thereto—there was neither an existing proceeding for such a determination pending in nor a judgment rendered by the Federal Court which would have been inconsistent with the adjudication in the State court.

Nor do the cases cited on page 29 of the plaintiffs' Brief support their appeal. None of those cases involved a collateral attack on an earlier judgment, and the decisions expressly pointed that out. In *Pete v. Henderson* (1954), 124 Cal. App. 2d 487, the action was by a party to the earlier judgment against his attorney for wrongfully permitting the earlier judgment to become final and immune to attack, the attorney having negligently failed to file a Notice of Appeal. The Court expressly recognized the integrity of the earlier judgment as between the parties that were bound thereby, but held that the action before it, involving different litigants, would not disturb the earlier judgment. In *Arenas v. U. S.* (9th Cir. 1952), 197 Fed. 2d 418, it was held that no collateral attack could be involved where the plaintiff in the second action was neither a party to nor in privity with any party to the first action and judgment, in which case she was not bound by any determination made in the first action. Simiarily in *Kluth v. Andrus* (1951), 101 N.E. 2d 310, the Court rejected the defendants claim of "collateral attack" in the second suit for the reason the that the plaintiff Kluth

> "was not a party and Kluth's status could not be affected by a case in which he was not made a party nor given opportunity to be heard. The

> findings of the trial court in the Patton case could not be res judicata as to Kluth or others not parties to that action. This principle appears to us so fundamental and so thoroughly recognized that we merely cite the following authorities . . ." 101 N.E. 2d at 314.

Other cases cited by the plaintiffs are inapplicable because the second action sought a determination of rights resulting from the happening of events subsequent to the rendition of the first judgment. The Court in *Commercial Securities v. Thompson* (1951), 239 S.W. 2d 911, swept aside the argument of collateral attack on this ground, saying at page 914:

> "We overrule appellant's contention, made under its first point of error, that the Wichita County suit is a collateral attack on the Harris County judgment. The integrity of the court's action in Harris County is not questioned in the present suit, nor is there an effort here to change said judgment in any way."

The action in *Hixon v. Cook* (1963), 379 Pac. 2d 677, sought to set aside the previously adjudicated homestead on the ground of later abandonment of the homestead and the Court, addressing itself to the collateral attack argument said:

> "Plaintiffs' petition in this case, and the district court judgment entered thereon, is not an attempt to 'avoid, defeat or evade' the county court order, or to 'deny its force and effect.' . . . The county court order has therefor been given full force and effect." 379 Pac. 2d at 684.

Other of the cases cited by plaintiffs involve only actions to construct or interpret a prior judgment. The Court in *Williams v. Nylund* (10th Cir. 1959), 268 Fed. 2d 91, said this with respect to the second action:

> "But appellants do not question the effectiveness of the Oklahoma decree through the instant action. They seek, rather, a construction of that judgment in connection with the purported exercise of power under it by appellee as trustee. They do not ask the federal court to defeat the probate court decree, but to interpret it . . . The interpretation of a judgment involves no challenge to its validity." (268 F. 2d at 94).

Interpretation, not collateral attack, was also involved in *Stavros v. Bradley* (1950), 313 Ky. 676, 232 S.W. 2d 1004, wherein the Court said at page 1005:

> "The interviewing petition of Stavros makes no collateral attack on the settlement suit judgment . . . Appellant admits this Judgment is correct and his intervening petition does not attack it . . . The intervenor asks the court to construe the Judgment . . ."

In *Rocky Mountain Fuel Co. v. Heflin* (1961), 148 Colo. 415, 366 Pac. 2d 577, the Court rejected the collateral attack argument saying at page 579 and 580:

> "This action involves an interpretation of certain reservations in the trustee's deed and does not involve an attack on a decree of the United States District Court."

2. IT WAS SUFFICIENTLY SHOWN THAT THE CALIFORNIA COURT MADE A FINDING THAT THE CITY HAD PAID THE CONDEMNATION AWARD.

Plaintiff's Opening Brief insists that in any event, City did not carry its burden of proving that the State Court had adjudicated the fact of payment of the condemnation award.

This is untenable. It was clear on the record before the District Court that the State Court had made a Final Order of Condemnation and that it contained a finding that a valid payment of the condemnation award had been made by the City.

Under California law, the Final Order of Condemnation is by definition a determination that payment of the condemnation award has been made, and that title to the property is vested in the condemnor. Section 1253 of the California Code of Civil Procedure provides:

> "When payments have been made . . . as required by Sections 1251 and 1252, the court shall make a final order of condemnation. . . . The title to the property . . . vests in the plaintiff . . . upon the date that a certified copy of the final order is recorded . . .".

Plaintiffs' own complaint in this action alleged the entry of a final order of condemnation in the State Court pursuant to payment of the award (Tr. 18), hence the making of the finding or determination of payment, which is the essential function of the final order, was apparent from plaintiff's own complaint. Whether it had been done was not in issue. It was conceded.

If further proof were necessary, it was present. An exact copy of the Final Order was attached to the City's answer as Exhibit D (Tr. 29),[7] and the Court was able to see precisely what the State Court judgment had determined.

The cases cited by plaintiffs on this score are not pertinent. The case of *Johnston v. Ota* (1941), 43 Cal. App. 2d 94, is cited to the effect that the City failed in its burden of proving what the judgment determined. But that case involved a "judgment of dismissal" based upon an order of the Court sustaining a general demurrer. It could not be determined what was adjudicated for purposes of *res judicata* by such a judgment of dismissal, and the Court properly so held. Similarly, the decision in *Garcia v. Venegas* (1951), 106 Cal. App. 2d 364 involved not a judgment which contained express findings, but a "document certified by the justice of the peace as a transcript of the pleadings and proceedings as appeared from his docket", and from which it could not be determined whether the pertinent issues had even been determined by the earlier proceeding.

---

3. OTHER GROUNDS ARE PRESENT FOR AFFIRMING THE JUDGMENT OF DISMISSAL.

In addition to the fact that the action was a collateral attack on the condemnation judgment of the

---

[7]The Exhibits to the Complaint and Answer were not duplicated in the copies made of the Transcript of the Record, but are attached to the original pleadings on file in the office of the Clerk of the Court of Appeals.

State Court, there were other reasons why the action could not be maintained. As these additional grounds were invoked by the City in support of its motion to dismiss in the District Court and were argued by the parties, the City reiterates them here in further support of the Judgment of Dismissal. The Court of Appeals should of course affirm the judgment if it was proper on any ground.

> "In the review of judicial proceedings the rule is settled that if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason." *Helvering v. Gowran* (1937), 302 U.S. 238, 245, 82 L.ed. 224, 230.

Accord, *J. E. Riley Invest. Co. v. Commissioner* (1940), 311 U.S. 55, 85 L.ed. 36; *Securities & Exchange Commission v. Chenery Corp.,* 318 U.S. 80, 87 L.ed. 626.

a. The action is not maintainable unless the plaintiffs comply with Rule 23(b) of the Federal Rules of Civil Procedure.

Considerable argument in the District Court was directed to whether the plaintiffs, who were not stockholders of Citizens of California but who were pledgees of the sole stockholder, were required to make the allegations required of a stockholder's derivative suit. (Rule 23(b), F.R.C.P.). The District Court pondered this question (Tr. 43 and 44) but in the end did not decide the point (Tr. 49 and 50) finding other grounds upon which to dismiss the action.

Rule 23(b) of the Federal Rules of Civil Procedure requires that a shareholder who brings an action

which may be brought by the corporation must make the following allegations:

> "(1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees, and, if necessary, from the shareholders such action as he desires, the reasons for his failure to obtain such action or the reasons for not making such effort."

Plaintiffs' complaint has no allegations complying with this rule.

The requirements of Rule 23(b) reflect the substantive rule of law that shareholders cannot independently sue on causes of action which belong to the corporation without first prevailing upon corporate officers to institute the litigation.

> "In the absence of statute, it is the generally accepted rule that misfeasance or negligence on the part of the managing officers of a corporation, resulting in loss of its assets, as alleged herein, is an injury to the corporation for which it must sue. A stockholder cannot sue for damages because his stock is thereby rendered worthless.
>
> "We find nothing in our statutory law opposed to the above conclusion." *Anderson v. Derrick* (1934), 220 Cal. 770 at 773 and 774.

> "Generally, a stockholder may not maintain an action in his own behalf for a wrong done by a third person to the corporation on the theory that such wrong devalued his stock and the stock of other shareholders, for such an action would authorize multitudinous litigation and ignore the corporate entity." *Sutter v. General Petroleum Corp.* (1946), 28 Cal. 2d 525, 530.

Accord, *Gagnon Co. Inc. v. Nevada Desert Inn* (1955), 45 Cal. 2d 448, at 453.

The general rule is the same throughout the United States.

> "In view of the legal concept of corporate entity under which stockholders as such lose their individualities in the individuality of the corporation as a separate and distinct person, and of the fact that stockholders by investing their money in the corporation recognize it as the person primarily entitled to control and manage its use for the common benefit of all the stockholders, it is a well-established general rule that a stockholder of a corporation has no personal or individual right of action against third persons, including officers and directors of the corporation, for a wrong or injury to the corporation which results in the destruction or depreciation of the value of his stock, since the wrong thus suffered by the stockholder is merely incidental to the wrong suffered by the corporation and affects all stockholders alike." 167 A.L.R. 279, at 280.

The wrong which plaintiffs complain of would of course be a wrong to the corporation, Citizens of California. The action is essentially a claim that the

water system was wrongfully taken from the corporation in that no valid payment of just compensation was made. If the deposit of $2,206,000 is "tainted" money and an ineffective payment of the condemnation award, the wrong is to Citizens of California. The corporation is the real party in interest, for if plaintiffs' action were successful in obtaining restoration, Citizens of California and not the plaintiffs would be entitled to it. The prayer of the complaint specifically asks for an adjudication (1) that the deposit of the $2,206,000 was not an effective payment to support the transfer of title and possession of the water system to the City (Tr. 23), (2) that the City holds the water system as trustee ex maleficio (Tr. 24), (3) that the conveyance of the water system is null and void, and that it be returned to Citizens of California (Tr. 24).

The question then is whether the plaintiffs, being not stockholders but pledgees of a stockholder, may bring an action for the recovery of corporate property without complying with Rule 23(b). In this connection, plaintiffs state on page 10 of their Brief that their standing to maintain the action "was conceded by the decision below," pointing to the lower Court's Memorandum dated January 30, 1963 (Tr. 43-45). This is not the case.

In the Memorandum referred to, the District Court noted some decisions which held that a pledgee of corporate stock had standing to sue and prevent the dissipation of the corporate assets, but it expressly

withheld its decision on whether it could be done *without* making the corporation a party and *without* complying with Rule 23(b), as plaintiffs are attempting to do here. In its final Memorandum granting the motion to dismiss the complaint, rendered on April 16, 1963, the Court characterized this question as one of the two principal issues confronting it, and expressly declined to rule upon it, having concluded that the action was not maintainable anyway.

> "Although there are a myriad of subordinate legal issues involved in this action, it appears to the Court that these issues boil down to but two, only one of which is of significance for present purposes. The two can be succinctly stated as follows: (1) Is an action of the nature of the present one properly brought by a pledgee as an individual, non-derivative action and without the joinder of the corporation whose shares of stock are involved; and (2) In an action of the present type, does the diversity jurisdiction of the federal courts require that this Court afford relief to plaintiffs. Since the Court has resolved the latter question in the negative, the former question need not be decided." (Tr. 49 and 50)

Several federal decisions have considered the nature of the action by the stock pledgee. However, no Court has ever had occasion to decide whether the pledgee must plead in accordance with Rule 23(b). They have, however, always characterized his standing to sue as being akin to that of a stockholder.

> "We think it beyond question that the pledgee of stock has such an equitable interest in it as

will entitle him to be heard in a court of equity concerning its preservation, and the protection of his interests therein, to the same extent, at least, as the stockholder pledging it would have." *Gorman Wright Co. v. Wright,* (4th Cir., 1904), 134 Fed. 363, 364.

"A pledgee of shares when the pledgor is insolvent has the standing of a shareholder for the purpose of protecting his interest." *Mutual Life Ins. Co. v. Menin* (2d Cir., 1940), 115 F. 2d 975, 980.

"It has been held by this court in Arcola Sugar Mills v. Burnham, 5 Cir., 67 F. 2d 981, that the pledgee of corporate stock could qualify under the rule (Rule 23 of the Federal Rules of Civil Procedure) and maintain such an action . . ." *Hurt v. Cotton States Fertilizer Co.* (7th Cir., 1944), 145 F. 2d 293, 295.

"It is not clearly true that the suit was not in behalf of the corporations, as separate legal entities, as well as in behalf of plaintiffs (pledgees)." *Cannon v. Parker* (5th Cir., 1945), 152 F. 2d 706, 708.

"In Arcola Sugar Mills Co. v. Burnham, 5th Cir., 67 F. 2d 981 it was held that the pledgee of shares could maintain a stockholder's suit in order to protect his interest and to prevent dissipation of the corporation's assets." *Weinhaus v. Gale* (7th Cir., 1956), 237 F. 2d 197, 200.

"In Arcola Sugar Mills Co. v. Burnham, 5th Cir., 67 F. 2d 981, it was held that the equitable interest of a mere pledgee qualified him under the rule (Rule 23(b)) to maintain such an action." *Richardson v. Blue Grass Mining Co.* (E. D. Ky. 1939), 29 F. Supp. 658, 665.

The pledgee cases which the plaintiffs refer to,[8] as well as the cases noted by the Court in its January 30, 1963 memorandum, do indeed hold that a pledgee of corporate stock may sue to prevent a dissipation or loss of the corporate assets, and the City does not dispute this principle. But the question here, which none of those cases decided, is whether the pledgee can bring such a suit without first prevailing upon the corporation to do so as required by Rule 23(b) and without making the corporation a party in the action. As the City pointed out in the District Court, in the cases holding that the pledgee may sue in the protection of his interest, they differed in two important respects from the present case, viz., it was apparent from those decisions that actual controversy existed between the pledgee and the corporation (or stockholder-pledgor) and the pledgee had brought both of them into Court as parties to the action. In *Cannon v. Parker* (5th Cir., 1946), 152 F. 2d 706, cited by plaintiffs as "analogous to the instant case" (Opening Brief, p. 11), the action was based upon the "dissipation of corporate assets" by the stockholder-pledgor, and other officers who were "looting the corporations", and the corporations were parties defendants. Plaintiff-pledgees could have, and from all that appears in the opinion did, plead in accordance with Rule 23(b) of the Federal Rules of Civil Procedure. *York Properties v. Neidoff* (1957), 170 N.Y.S. 2d 683, the other case cited by plaintiffs, was

---

[8]*York Properties, Inc. v. Neidoff,* 170 N.Y.S. 2d 683; *Cannon v. Parker* (5th Cir., 1945), 152 F.2d 706.

a case where the pledgee alleged and sued to stop active mismanagement of the corporate affairs by those in charge of the corporation, and the Court specifically held that the corporation was a necessary party defendant and had to be brought in by supplemental summons. The action was labeled in the report of the case as a "(d)erivative suit by pledgee of corporate stock."

In this case, neither the stockholder-pledgor nor the corporation are parties to the action, nor does it appear that they are at odds with the pledgee on whether the action should be brought. Plaintiffs neither bring the corporation before the Court so that the reasons for its inaction can be known, nor allege under Rule 23(b) that they attempted to prevail upon the corporation to bring the action.

The principle and purpose underlying Rule 23(b) require that a stock pledgee be made to plead in conformity with the Rule, at least where the pledgee does not join the corporation as a party and no reason appears in the complaint for the corporation's failure to bring the action. The reasons for the requirement were spelled out in *Hawes v. Oakland* (1882), 104 U.S. 450, 26 L.ed 827, from which Rule 23(b) is derived. 3 Moore's Federal Practice, § 23.15, p. 3490.

The first reason is that the stockholders should not institute and conduct litigation in the name of and on behalf of the corporation which its directors have declined to pursue as a matter of business judgment.

> ". . . there may be a variety of things of which a company may well be entitled to complain but

> which, as a matter of good sense, they do not think it right to make the subject of litigation, and it is the company as a company which has to determine whether it will make anything that is a wrong to the company a subject-matter of litigation or whether it will take steps to prevent the wrong from being done." 26 L.ed. at page 831.

Accordingly, to assure that the stockholder can press the corporation unwillingly into Court only where the conduct of those controlling the corporation is *ultra vires*, illegal, oppressive, or fraudulent, Rule 23(b) requires a shareholder to

> "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

If a stock pledgee may ignore this requirement where the wrongful taking of or injury to the corporate property was done by a stranger to the corporation, where those controlling the corporation would logically be the first to seek redress, then the stock pledgee is permitted to ignore the will and judgment of the corporation; the reasoning that a stockholder should not do this applies equally to the pledgee of the stockholder, so the rule should also.

More importantly, a pledge of stock is a legal arrangement easily and commonly created by stockholders. If this Court holds that Rule 23(b) is in-

applicable to pledgees in this kind of case, a large and serious loophole is created. Shareholders would have an easy and obvious means of avoiding the rule of *Hawes v. Oakland.*

Secondly, the Supreme Court in *Hawes v. Oakland*, was concerned about stockholders bringing derivative suits only to bring the case into the Federal Court on diversity jurisdiction, when actually no diversity existed between the corporation and the adversary.

> "A corporation having such a controversy, which it is foreseen must end in litigation, and preferring for any reason whatever that this litigation shall take place in a Federal Court, in which it can neither sue its real antagonist nor be sued by it, has recourse to a holder of one of its shares, who is a citizen of another State. This stockholder is called into consultation, and is told that his corporation has rights which the directors refuse to enforce or to protect. He instantly demands of them to do their duty in this regard, which of course they fail or refuse to do, and thereupon he discovers that he has two causes of action entitling him to equitable relief in a court of chancery; . . ." 26 L.ed. at page 829.

The consequence of this consented-to but feigned jurisdiction is that

> "the overburdened courts of the United States have this additional important litigation imposed upon them by a simulated and conventional arrangement, unauthorized by the facts of the case or by the sound principles of equity jurisdiction." 26 L.ed. at page 829.

To avoid this, the Court said that the stockholders pleading should state "that the suit is not a collusive one to confer on a Court of the United States jurisdiction in a case of which it could otherwise have no cognizance . . .", and accordingly, Rule 23(b) requires such an allegation. To waive this requirement in the case of a stock-pledgee creates an additional loophole, for a corporation in dispute with a citizen in its own state, desiring that the litigation be in the federal court, may simply avoid the jurisdictional barrier by arranging institution of the litigation by a stock pledgee.

It is submitted that this Court should affirm the Judgment of Dismissal on the additional ground of the failure of the plaintiff-pledgees to plead in conformity with Rule 23(b), thus failing to state a claim upon which relief can be granted. The reasons requiring stockholders to comply with the Rule is fully applicable to the plaintiffs in this case. To permit pledgees to ignore the Rule would open the way to avoidance of it by stockholders, and permit collusion to obtain federal jurisdiction.

There is one additional point to be dealt with relative to plaintiffs' right to maintain the action. Plaintiffs sought to distinguish their action below from a stockholder's derivative action on the additional ground that under the Indenture of Mortgage and Deed of Trust, they were entitled to receive the condemnation award and it being "tainted" and subject to recovery by bondbuyers, they were thereby exposed to liability; that in the premises they were suing

in their own right, independent from any right of the corporation, preventing jeopardy to their security. This facade to plaintiffs' standing to sue reappears on page 3 of their Opening Brief, where they assert that

> "Plaintiffs are entitled, under the terms and provisions of the Indenture of Mortgage and Deed of Trust, to receive all of the proceeds resulting from condemnation of property of Citizens of California."

As was pointed out heretofore, the plaintiffs' claim to the condemnation award is grounded upon their agreement (Indenture of Mortgage and Deed of Trust) with the sole stockholder in Citizens of California and their right in that regard is no greater than that of the stockholder himself.

A stockholder has no separate or independent rights in corporate property, and cannot convey or agree to convey corporate property, *Gashwiler v. Willis* (1867), 33 Cal. 11. This principle is recognized everywhere:

> "The distinction between the title of a corporation, and the interest of its members or stockholders, in the property of the corporation, is familiar and well settled. The ownership of that property is in the corporation, and not in the holders of the shares of its stock." *Gibbons v. Mahon,* 136 U.S. 549 at 557, 34 L.ed. 525, 527.

> "Stockholders, even the controlling stockholder, cannot transfer or assign the corporation's properties and rights . . . By such a transfer no title is acquired by the transferee, since the transfer

> is not a corporate act." 1 Fletcher, Cyclopedia Corporations, section 31, page 115.
>
> "The same rules, as stated in the preceding section, necessarily apply to mortgages and pledges." Section 32, page 119.

The City of course has no concern or interest in whether Citizens of California or the plaintiffs ultimately in fact receive the condemnation award, but it does point out that the stockholder has taken it upon himself to declare a right in plaintiffs to the corporation's condemnation award, and plaintiffs' right thereto is therefore the same as, but no greater than, that of the stockholder would be. Such a declaration by the stockholder would be ineffective to create in himself any independent or personal action should the property be paid for with "tainted" money. The cause of action in such case is still within the corporation, and can be asserted by the stockholders only as a derivative suit, viz., in accordance with Rule 23(b). The standing of the plaintiffs is no different than this.

Plaintiffs' Brief also suggests that their standing is analogous to that of a mortgagee of corporate property, citing *Consolidated Water Co. v. City of San Diego* (S.D. Cal., 1878), 89 F. 272; *East River Savings Bank v. State,* 43 N.Y.S. 2d 703; and *Bunyan v. Commissioner of Palisades Interstate Park,* 153 N.Y. Supp. 622.

But no such analogy is appropriate, for as the Court said in the first of the above-cited cases, there is a

> "radical difference that exists between the relation of a stockholder to the corporation and that of the holder of its bonds secured by a mortgage. The interest conveyed by mortgage vests, in my opinion, in the mortgage a separate and independent interest, which the mortgagee has a separate and independent right to protect when unlawfully assailed." 89 F., at 273.

Plaintiffs as pledgees merely hold the stock of the shareholder as security for bonds issued by the shareholder. As beneficiaries of the shareholder's "assignment" to them of the proceeds of the condemnation award, they are merely assignees of the shareholder. In either case, they stand in the shoes of the shareholder, and can no more analogize their position to that of a *corporate* mortgagee than the shareholder himself might do. The shareholder could only bring this action in compliance with Rule 23(b) and by naming the corporation as a party, and it follows that plaintiffs must do likewise.

> ". . . what they (the shareholders) could not do themselves they could not by resolution or otherwise authorize another to do for them." *Gashwiler v. Willis* (1867), 33 Cal. 11, at 19.

b. The action should be dismissed because plaintiffs have failed to join indispensable parties.

The corporation is an indispensable party in a shareholder's derivative suit.

> ". . . it has been settled law for over a century . . . that the wronged corporation is an indispensable party to a shareholder's action." *Green-*

> *berg v. Giannini* (2nd Cir., 1944), 140 F. 2d 550, 554.
>
> "Manifestly the proceedings for this purpose should be so conducted that any decree which shall be made on the merits shall conclude the corporation. This can be done by making the corporation a party defendant . . . It would be wrong, in case the shareholders were unsuccessful to allow the corporation to renew the litigation in another suit, involving precisely the same subject matter." *Davenport v. Dows* (1874), 85 U.S. 626, 627, 21 L.ed. 938.

The corporation is likewise an indispensable party in a shareholder's suit under the law of California. *Beyerbock v. Juno Oil Co.,* 42 Cal. 2d 11, 265 P. 2d 1; *Keller v. Schulte,* 47 Cal. 2d 801, 306 P. 2d 430.

It is clear from a reading of the complaint in this action that Citizens of California is an indispensable party, whether or not the action is labeled a stockholder's derivative action. The gist of the action is that no valid payment of the condemnation award was made in the State Court condemnation proceeding between the City and Citizens of California. The complaint prays for judgment declaring that the deposit is not effective to transfer title to the water system, that the purported taking is an unconstitutional taking of the corporation's property, that defendants hold the water system as trustees, that they are not entitled to title and possession of the system, that the purported conveyance of the water system is null and void, and that the water system be returned to the

corporation (Tr. 23-25). The test this Court laid down in *State of Washington v. United States* (1936), 87 F. 2d 421, makes it clear that Citizens of California is an indispensable party.

> "After first determining that such party is interested in the controversy, the court must make a determination of the following questions applied to the particular case: (1) Is the interest of the absent party distinct and severable? (2) In the absence of such party, can the court render justice between the parties before it? (3) Will the decree made, in the absence of such party have no injurious effect on the interest of such absent party? (4) Will the final determination, in the absence of such party, be consistent with equity and good conscience?
>
> "If, after the court determines that an absent party is interested in the controversy, it finds that all of the four questions outlined above are answered in the affirmative with respect to the absent party's interest, then such absent party is a necessary party. However, if any one of the four questions is answered in the negative, then the absent party is indispensable." 87 F. 2d at 427.

The plaintiffs intimated to the District Court (Tr. 51) that they could avoid the problem of an absent indispensable party by waiving a portion of their requested relief. This is not the law,[9] but even if it

---

[9]"It is the relief sought that determines indispensability . . ." *Pioche Mines v. Fidelity Trust Co.* (9th Cir., 1953), 202 F.2d 944, 948.

were, their skeletonized object is still a determination that the deposit of $2,206,000 was an ineffective payment and that *they* did not have to accept it. Whether plaintiffs accept the condemnation award is a matter of total indifference to the City and its officers; but a determination that no valid payment was made would collide directly with the State Court determination; and reopen the controversy over possession and title to the system. The finding would entitle Citizens of California to a return of the water system.

There is a separate reason that Citizens of California is indispensable. The requested relief would require the Court to adjudge that plaintiffs were entitled to receive the condemnation award made to Citizens of California upon the basis of an agreement with its sole stockholder. Citizens of California should be present if such a determination is made.

There is also absent from the litigation all of the persons who purchased or hold the City's Water Revenue Bonds. Despite their absence, the complaint seeks a determination that the bond sale was illegal and improper because of certain misrepresentations by the City (Tr. 21, par. 57 of complaint). This would be a direct adjudication of the rights and interests of the bondholders; if it is true, they should participate, yet not one of them is before the Court.

Plaintiffs apparently seek to avoid the consequences of their failure to join indispensable parties by characterizing their complaint as seeking "an *in personam* declaratory judgment against defendants . . ." (Opening Brief, page 2). That is to say, they ask the Court

to make a determination that the City did (or did not) make valid payment of just compensation to Citizens of California, but provide that it not be binding upon Citizens of California; and further, to make a determination that the City did (or did not) commit fraud upon the purchasers of the bonds, but provide that it not be binding upon the bond buyers. Obviously, such a position is absurd to the City, as it could then be required to relitigate those issues with the absent parties. That alone is sufficient to treat them as indispensable. The Supreme Court said in the similar case of *Niles-Bement Co. v. Iron Moulders Union* (1920), 254 U.S. 77, 65 L.ed. 145, that

> "any decree rendered would not prevent a relitigating of the same questions in the same or any other proper court, and it would settle nothing.
>
> "Thus, if the (absent party) be considered as having any corporate existence whatever separate from that of the petitioner, it must have an interest in the controversy . . . of a nature that such a final decree could not be made without affecting that interest, and perhaps not without leaving the controversy in a condition wholly inconsistent with that equity which seeks to put an end to litigation by doing complete and final justice; and therefore it must be concluded that it was an indispensable party, within the quoted long established rule." 254 U.S. at 81.

The Third Circuit ruled the same way in *Fitzgerald v. Haynes* (1957), 241 F. 2d 417, saying at page 419:

> "In the present case a decision on the merits in favor of the insurgent defendants would be an

> adjudication against the right of Locals 636 and 639, as now constituted, to union property. Yet, in the absence of those locals such an adjudication could not bind them or prevent them from relitigating the same controversy. Such considerations are most persuasive reasons for holding that the absent locals should be viewed as indispensable parties (citing cases)".

The absence of indispensable parties cannot be avoided by asking the Court for such a hollow judgment as plaintiffs propose. There is no valid reason why the Courts should determine the same issue three or more times and there is certainly no reason why the City should have to litigate the same issue over again with absent parties. There is no possible decree in this case that would be "consistent with equity and good conscience," nor can the Court "render justice between the parties before it", as it must be able to do under *Washington v. United States, Supra.* Both the corporation, Citizens of California, and the bondholders are indispensable parties.

When the plaintiffs fail to join an indispensable party, the action must be dismissed by the Court. *Shields v. Barrow,* 58 U.S. 130, 15 L.ed. 158; *Pioche Mines v. Fidelity Trust Co.,* (9th Cir,. 1953), 202 F. 2d 944; *Minnis v. Southern Pacific Co.* (9th Cir., 1938), 98 F. 2d 913; *State of Washington v. United States* (9th Cir., 1936), 87 F. 2d 421, 427; *Kohler v. McClellan,* 71 F. Supp. 308, 315 (corporation not made a party in a stockholder's suit). Hence, the judgment of Dismissal can be sustained on this separate ground.

c. Even if Citizens of California were joined in the action, it would have to be aligned as a plaintiff, and thus diversity jurisdiction would be destroyed.

An indispensable party in this instance, Citizens of California, is a California corporation (complaint, para. 10), hence is a citizen of California. 28 U.S.C. § 1332(c). Its principal place of business is in North Sacramento, California (complaint, para. 10), hence it can be sued within and is subject to the jurisdiction of the District Court for the Northern District of California, 28 U.S.C. § 1391(c); *Galveston, H. & S.A. Ry. Co. v. Gonzales,* 151 U.S. 496, 38 L.ed. 248, 14 S. Ct. 401.

The indispensable party being within the jurisdiction of this Court, the Court has the power to order it summoned to appear in the action, in lieu of dismissal, *Keene v. Hale-Halsell Co.* (5th Cir., 1941), 118 F. 2d 332, but in its discretion it need not do so, *U.S. v. Elfer* (9th Cir., 1957), 246 F. 2d 941, and if the presence of the indispensable party would eliminate diversity of citizenship, the action must be dismissed. *Gaw v. Higham* (6th Cir., 1959), 267 F. 2d 355; *Flaherty v. McDonald* (S.D. Cal., 1959), 178 F. Supp. 544.

The complaint alleges that the sale of the defendant city's water bonds was fraudulent and irregular, hence payment of the condemnation award with the proceeds thereof made the taking of the property of Citizens of California wrongful. It is not alleged that Citizens of California was a party to this wrongdoing, and it is not alleged that Citizens of California has refused to rectify this wrongful taking of its property.

The complaint is absolutely silent as respects Citizens of California, except for the prayer that the water system be returned to it. No cause of action in the plaintiff is stated against Citizens of California nor is any relief asked against Citizens of California. There is no sign of antagonism between it and plaintiff anywhere in the complaint.[10] The only thing that the complaint indicates is that Citizens of California, like the plaintiffs in this federal action, challenged the condemnation of the water system on many grounds. The doctrine of realignment requires a nominal defendant to be treated as a plaintiff for the purpose of defining the real controversy where no real cause of action is asserted against him by the plaintiff. *Indianapolis v. Chase National Bank,* 314 U.S. 63, 86 L.ed. 47, 62 S. St. 15.

> "The omission of any prayer for relief against the railroad simply shows that properly it is to be treated as a plaintiff in this case". *Steele v. Culver* (1908), 211 U.S. 26, at 29, 53 L.ed. 74, at 75.

Accord, *Green v. Green* (7th Cir., 1955), 218 F. 2d 130, at 139.

In this situation, it cannot be seriously questioned that the plaintiffs and Citizens of California have a common interest in the relief sought; and the latter, if made a party, would have to be aligned as a plaintiff for the purposes of testing jurisdiction. The controversy would then involve two citizens of the same state, to wit, California, thus destroying diversity and

---

[10]Plaintiffs' attorneys are general counsel for Citizens of Delaware, parent company to Citizens of California.

the jurisdiction of this Court to proceed, *Dawson v. Columbia Avenue Savings Co.* (1904), 197 U.S. 178, 49 L.ed. 713; *Indianapolis v. Chase National Bank* (1941), 314 U.S. 63, 86 L.ed. 47.

In the *Dawson* case cited, there is a remarkably parallel situation, a suit brought by a mortgagee of a waterworks company against a city, naming the waterworks company as a defendant. The Court could see from the pleadings that the interest of the mortgagee and the waterworks company was the same, and dismissed the suit. Justice Holmes said:

> "If we assume that the plaintiff is more than an assignee of the city's contract to pay (which we do not intimate), still, when the arrangement of the parties is merely a contrivance between friends for the purpose of founding a jurisdiction which otherwise would not exist, the device cannot be allowed to succeed." 197 U.S. at 181, 49 L.ed. at 716.

Thus the District Court lacked jurisdiction in the absence of Citizens of California for want of an indispensable party, and would have lacked jurisdiction had that party been joined, for want of diversity. The Judgment of Dismissal should accordingly be affirmed on this additional ground.

d. Plaintiffs have not demonstrated that this action could be independently brought in a California Court.

In *County of Alleghany v. Mashuda Company,* 360 U.S. 185, relied on by plaintiffs as authority for Federal Courts to set aside State Court condemnations, the Court relied heavily on its conclusion that Penn-

sylvania law permitted a separate action to challenge the taking involved there. In that case, the Board of Commissioners of the county passed a resolution which had the effect of condemning Mashuda's land. Viewers were appointed to assess compensation, and both parties appealed from their award to the County Court of Common Pleas. Some time later Mashuda brought an action in Federal Court to determine the validity of the taking, on the ground that it was for private, not public, use. The Court of Appeals held, and the U.S. Supreme Court agreed, that a separate action to challenge the taking on this ground was clearly proper under Pennsylvania law, and that therefore the separate action could be brought in Federal Court, where diversity existed.

There the Federal Courts were dealing with the first judicial test of the validity of the taking, a matter which had not been determined by any Pennsylvania Court. It was dealing with a situation where state law contemplated that a judicial challenge to the right to take could be made in a separate action.

None of the circumstances of the *Mashuda* case are applicable here. Citizens of California had every opportunity to challenge the taking by motion to vacate the final order in the Trial Court, and on appeal. Plaintiffs do not find any provision in California law for a collateral attack on such a judgment; section 1252 provides for a direct attack on the judgment in the Court that rendered it in the event of nonpayment, which is claimed here, and there is no reason or precedent whatever for any other remedy. The

Supreme Court in the *Mashuda* case emphasized the importance of the possibility of collateral attack under state law to federal jurisdiction. The Federal Court could proceed if

> "the same suit to contest the validity of the taking could be brought in a state court different from the one in which the damage proceeding is now pending. It is perfectly clear under Pennsylvania law that the respondent could have challenged the validity of the taking . . . in a suit brought in a Court of Common Pleas independent of the damage proceedings pending . . ." 360 U.S., at page 190.

> "Respondents, it bears repetition, could have brought this very suit in a state court different from the one in which the damage proceeding is pending and an adjudication of that validity suit by the state court would have the same effect on the pending damage proceeding as will the federal court adjudication . . . considerations of comity are satisfied if the District Court acts toward the pending state damage proceedings in the same manner as would a state court." 360 U.S. at page 191.

Plaintiffs have not shown anywhere that their action could have been brought in a California Court different from that which rendered the condemnation judgment. In fact it could not be. *McPherson v. City of Los Angeles* (1937), 8 Cal. 2d 748.

As a final point, plaintiffs challenge the District Court's construction of *Thibodo v. United States,* 187 F. 2d 249 (p. 33 of Appellants' Brief) distinguishing *Thibodo* on the ground that theirs is an action based

upon diversity of citizenship. However, the District Court's only point was that *Thibodo* barred their action to the extent that jurisdiction might be founded upon the raising of a federal constitutional question, which plaintiffs do not assert here (Brief, pp. 1 and 2).

CONCLUSION

Plaintiffs, as pledgees and assignees of a stockholder, ask the federal court to redetermine issues that were formerly adjudicated by the California Superior Court in an action in which the corporation was a party, by a judgment from which the corporation appealed through the State Courts. They ask the Court to permit them to do so without their first asking the corporation to bring the action, and without their even making the corporation a party. Absence of the corporation and other parties whose rights and liabilities would be in issue can be cured, they say, on the theory that the judgment, while defining the rights of the absent parties against the City, will not be binding upon them nor the City. The plaintiffs ask the Court to spend its time and the City to expend its funds to litigate the contentions they raise, without settling anything.

The City spent nearly six years in the State Courts prosecuting the condemnation of the water system serving its inhabitants. Citizens of California prosecuted a seemingly endless procession of appeals on point after point, three times through the California

District Court of Appeal, and the California Supreme Court, and once to the United States Supreme Court, without ever having its contentions sustained. Against this background, the position of the plaintiffs, standing in the shoes of the sole stockholder of Citizens of California, that the condemnation judgment be reopened, the validity of the taking be again considered, the City's bonds invalidated and the system returned to Citizens of California, all without joining Citizens of California or any representative of the bondholders, accords with neither law nor justice.

The Judgment of Dismissal should be affirmed.

Dated, January 21, 1964.

Respectfully submitted,

RAYMOND MCCLURE,
MARTIN MCDONOUGH,
DANIEL F. GALLERY,
Attorneys for Appellee City of North Sacramento.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

MARTIN MCDONOUGH.